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1-0300.00 BASICS OF ACCOUNTING

Basic financial statements present information concerning an organization's financial position on a certain date, changes in that position and results of operations during a period ending on that date. Financial statements presenting the financial position at a certain date are called balance sheets, and statements reflecting changes in that position and results of operations during a period ending on that date are called operating statements.

1-0300.10 BALANCE SHEET

The financial position information presented on the balance sheet indicates what an organization owns, what it owes, and the difference which is a measure of its net worth. These elements of financial position and their relationship to each other are summarized mathematically in the basic accounting equation:

OWNED - OWED = NET WORTH

In accounting terminology, things that are owned are called assets, things that are owed are called liabilities, and net worth is usually referred to as equity. By applying this terminology, we can restate the accounting equation as follows:

OWNED - OWED = NET WORTH

ASSETS - LIABILITIES = EQUITY (FUND BALANCE OR RETAINED EARNINGS)

To illustrate, assume that an organization has cash in the bank of $6,000 and owes $5,000. What is its equity? Since assets (what is owned) less liabilities (what is owed) equals equity -

ASSETS - LIABILITIES = EQUITY

$6,000 - $5,000 = $1,000

Try another one: assume that another organization has $200,000 in the bank, but it owes salaries to employees in the amount of $175,000.

What is its equity? Since equity equals assets minus liabilities, then -

ASSETS - LIABILITIES = EQUITY

$200,000 - $175,000 = EQUITY

$25,000 = EQUITY

1-0300.10 BALANCE SHEET (Cont'd)

Assume, now, that we know the value of liabilities and equity. Can we determine the value of assets? In the preceding example, we state that assets - liabilities = equity. Using the same amounts for equity and liabilities we would have:

ASSETS	-	LIABILITIES	=	EQUITY
ASSETS	-	$175,000	=	$25,000

or

ASSETS	=	LIABILITIES	+	EQUITY
ASSETS	=	$175,000	+	$25,000

Thus, we derive that the value of assets is $200,000.

We have now stated the accounting equation two ways:

1.	ASSETS	-	LIABILITIES	=	EQUITY
	$200,000	-	$175,000	=	$25,000
2.	ASSETS	=	LIABILITIES	+	EQUITY
	$200,000	=	$175,000	+	$25,000

The accounting equation can be added to or subtracted from as long as the same amount is added or subtracted on both sides of the equation. It is important to remember that the equation must always be in balance.

Current Assets and Liabilities

Assets and liabilities are further classified according to their degree of permanency. Assets which are likely to be used up, or converted into cash, within the next year (cash, investments, most receivables, inventories, etc.) are called current assets. Longer lived assets, land, buildings, equipment, etc., are called fixed assets. Similarly, liabilities payable within one year are called current liabilities and those payable in more than one year are called long-term liabilities. The difference between current assets and current liabilities is called net current assets. It is a measure of an organization's liquidity. These elements of an organization's liquid financial position and their relationships to each other can be summarized by the basic accounting equation as follows:

CURRENT ASSETS - CURRENT LIABILITIES = NET CURRENT ASSETS

To be considered financially healthy, an organization must meet both liquidity (sufficient net current assets) and solvency (sufficient equity) tests.

1-0300.20 OPERATING STATEMENT

Results of operations can be measured and reported in several different ways.

Cash Receipts and Disbursements

Cash receipts are increases in cash; cash disbursements are decreases in cash. The statement of cash receipts and disbursements is an operating statement which summarizes cash flows during a period.

Revenues and Expenditures - Governmental Fund Types

Revenues are additions to assets which do not incur an obligation and do not represent exchanges of property for money. Expenditures are charges incurred whether paid or unpaid, which are presumed to benefit the current fiscal year. A statement of revenues and expenditures, therefore, summarizes the receiving and spending activities of an organization during a period.

Revenues and Expenses - Proprietary Fund Types

Revenues are increases in equity and expenses are decreases in equity. The principal way in which expenses differ from expenditures is that expenses include the cost of using fixed assets over time (depreciation expense), even though the expenditures for those costs may not be reflected in current financial activity. A statement of revenues and expenses summarizes the effect which an organization's financial operations during a period have had on its equity.

Commercial vs. Governmental Accounting

In our free enterprise system, business organizations are permitted significant discretion in choosing how to spend their resources. Further, since business organizations exist primarily to earn profits, accounting standards governing their behavior place minimal emphasis on spending activities and focus almost exclusively on the extent to which operations have maintained or added to net worth, or equity.

Americans as taxpayers, on the other hand, are not nearly so inclined to allow their governments similar discretion in deciding how to spend public monies. Further, earning a profit is at best a secondary objective even for functions of government with profit-producing activities. Americans have not, therefore, found business accounting standards particularly useful for evaluating their government's financial activities and have turned instead to an accounting system which emphasizes the control of spending. This is done through the establishment of budgets and the preparation of reports which show the extent of compliance with the budget. The legal authority to spend in a governmental organization is the approved budget or the appropriation.

1-0310.00 FUND ACCOUNTING

Often, different functions of a governmental activity require different kinds of controls. To accommodate this need, separate funds are established to account separately for resources affected by different types of spending restrictions. Separate funds are required when unique reporting requirements exist. This process is referred to as fund accounting. Fund accounting allows a government to account for part of its activities using business accounting standards and the rest using governmental accounting standards.

1-0310.00 FUND ACCOUNTING (Cont'd)

Three categories of funds are used:

- Governmental funds
- Proprietary funds
- Fiduciary funds

Governmental Funds

Governmental funds are used to account for governmental activities financed primarily from taxes and state and federal appropriations. They are accounted for using governmental accounting standards. Therefore, they generally report only current assets and current liabilities on their balance sheets and their primary operating statement is the statement of revenues and expenditures. Their equity consists of the accounts called fund balance and reserves. The relationship between a governmental fund's statement of revenues and expenditures and its balance sheet can be indicated using the accounting equation as follows:

FUND BALANCE EQUITY (At Start of Year)	+	REVENUES (During Year)	-	EXPENDITURES (During Year)	=	FUND BALANCE EQUITY (At End of Year)
35,000	+	175,000	-	180,000	=	30,000

Another equation would be:

EQUITY (At End of Year)	=	ASSETS (At End of Year)	-	LIABILITIES (At End of Year)
30,000	=	150,000	-	120,000

Proprietary Funds

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises and/or where the intent is that they be financed primarily from user charges. They are accounted for using business accounting standards. Therefore, their primary operating statement is the statement of revenues and expenses and their equity consists of separate invested monies (called contributed capital) and earned monies (called retained earnings).

The fact that the statement of revenues and expenses reflects changes during the year in fund equity is indicated in the previous accounting equation.

1-0310.00 FUND ACCOUNTING (Cont'd)

Fiduciary Funds

Fiduciary funds are used to account for activities undertaken by a government on behalf of, or in a fiduciary capacity for, some other persons or groups. Fiduciary funds are accounted for as either proprietary or governmental. Nonexpendable trust and pension trust funds are treated like governmental funds. Agency funds are purely custodial (assets exactly equal liabilities and, hence, equity is always zero) and thus do not involve measurement of results of operations.

1-0310.10 RELATIONSHIP OF BALANCE SHEET AND OPERATING STATEMENT

It is possible to demonstrate the effect of financial transactions on the accounts by using the accounting equation. Amounts can be added to or subtracted from the equation as long as equal amounts are applied to both sides. The equation must always be in balance; its equality must be maintained.

Certain types of transactions affect only assets and liabilities and hence only the balance sheet. Three such transactions are illustrated below:

1. An asset can be increased and another asset decreased an equal amount. For example, a district purchases $5,000 of investments (asset) and disburses cash (asset). The asset account "Investment" has been increased but the asset account "Cash" has been decreased by the same amount, $5,000. Hence, we still have the same total assets. Thus,

ASSETS	=	LIABILITIES	+	EQUITY
50,000	=	22,000	+	28,000
50,000	=	22,000	+	28,000

2. An asset can be increased and a liability increased an equal amount. For example, a district borrows $8,000 for the current year (liability) and receives cash (asset). The asset account "Cash" has been increased and a liability account "Loan Payable" has been increased by the same amount, $8,000. Now the accounting equation looks like this,

ASSETS	=	LIABILITIES	+	EQUITY
50,000	=	22,000	+	28,000
50,000 + 8,000	=	22,000 + 8,000	+	28,000
58,000	=	30,000	+	28,000

1-0310.10 RELATIONSHIP OF BALANCE SHEET AND OPERATING STATEMENT (Cont'd)

3. An asset can be decreased and a liability decreased an equal amount. For example, a district issues checks (asset) totaling $4,000 to vendors, paying off some accounts payable (liability). The liability account "Accounts Payable" is decreased and the asset account "Cash" is also decreased by a like amount, $4,000. Thus,

ASSETS	=	LIABILITIES	+	EQUITY
50,000	=	22,000	+	28,000
50,000 - 4,000	=	22,000 - 4,000	+	28,000
46,000	=	18,000	+	28,000

There are two other types of transactions that affect equity-revenues and expenditures (or expenses). Revenues increase equity while expenditures (or expenses) decrease equity. The accounting equation now can be expanded as follows:

ASSETS = LIABILITIES + (EQUITY + REVENUES - EXPENDITURES)

To illustrate the expanded equation, these examples are given.

1. A district receives approval from the Superintendent of Public Instruction for a State Aid Claim totaling $9,000. The asset account, "Accounts Receivable," is increased and the "Revenue" account is increased.

ASSETS (At End of Year)	-	LIABILITIES (At End of Year)	=	FUND EQUITY (At Start of Year)	+	REVENUES (During the Year)	-	EXPENDITURES (During the Year)
50,000	-	22,000	=	28,000				
50,000 + 9,000	-	22,000	=	28,000	+	9,000	-	0
59,000	-	22,000	=	28,000	+	9,000		

This transaction increased the Fund Balance $9,000 (by increasing revenues) while maintaining the balance in the accounting equation.

1-0310.10 RELATIONSHIP OF BALANCE SHEET AND OPERATING STATEMENT (Cont'd)

2. The district approves invoices for payment amounting to $7,000. This increases "Expenditures" and it increases the liability "Accounts Payable."

ASSETS (At End of Year)	=	LIABILITIES (At End of Year)	+	FUND EQUITY (At Start of Year)	+	REVENUES (During the Year)	-	EXPENDITURES (During the Year)
50,000	=	22,000	+	28,000				
50,000	=	22,000 + 7,000	+	28,000	+	0	-	7,000
50,000	=	29,000	+	21,000				

This transaction decreases the Fund Balance $7,000 (by increasing expenditures) while maintaining the balance in the accounting equation.

1-0320.00 DEBITS AND CREDITS

As illustrated earlier in this chapter, each financial transaction increases or decreases the district accounts. Accounting shows these increases or decreases as debits or credits. These terms are sometimes abbreviated, as follows:

Debit - DR

Credit - CR

You can think of a general ledger account as looking like a "T." The left side of an account is called the debit side; the right side is called the credit side.

An Account	
Debit Side	Credit Side

A debit will either increase or decrease an account depending upon where that account appears in the accounting equation. The same thing is true of a credit.

The accounting equation is illustrated to show where debits and credits appear as increases (Inc.) or decreases (Dec.)

Assets		=	Liabilities		+	Fund Equity		+	Revenues		-	Expenditures	
Debit Inc.	Credit Dec.		Debit Dec.	Credit Inc.		Debit Dec.	Credit Inc.		Debit Dec.	Credit Inc.		Debit Inc.	Credit Dec.

1-0320.00 DEBITS AND CREDITS (Cont'd)

Since the accounting equation must always be in balance (i.e., ASSETS = LIABILITIES + FUND BALANCE), every transaction must always be made up of debit amounts equal to the credit amounts posted. Each transaction must be analyzed individually to determine which accounts are increased and decreased, resulting in specific debits and credits. The affect of debits and credits on the accounts may be illustrated as follows:

Account	Normal Balance	Debit	Credit
Assets	Debit	Increase	Decrease
Liabilities	Credit	Decrease	Increase
Fund Equity	Credit	Decrease	Increase
Revenues	Credit	Decrease	Increase
Expenditures	Debit	Increase	Decrease

To further illustrate the use of debits and credits, some examples are presented:

1. Assume that the district began the year with assets of $20,000, no liabilities and a fund equity of $20,000.

Assets		=	Liabilities	+	Fund Equity	+	Revenues	-	Expenditures
Debit Inc.	Credit Dec.	Debit Dec.	Credit Inc.	Debit Dec.	Credit Inc.	Debit Dec.	Credit Inc.	Debit Inc.	Credit Dec.
20,000	=		0 +		20,000				

2. The district receives approval of the State aid claim totaling $8,000. This transaction increases assets and increases revenues by the same amount.

Assets		=	Liabilities	+	Fund Balance	+	Revenues	-	Expenditures
Debit Inc.	Credit Dec.	Debit Dec.	Credit Inc.	Debit Dec.	Credit Inc.	Debit Dec.	Credit Inc.	Debit Inc.	Credit Dec.
(1) 20,000					20,000				
(2) 8,000							8,000		
(T) 28,000	=		0 +		20,000 +		8,000 -	0	

3. The district received invoices for expenditures totaling $6,000. This transaction increases expenditures and increases liabilities.

Assets		=	Liabilities	+	Fund Balance	+	Revenues	-	Expenditures
Debit Inc.	Credit Dec.	Debit Dec.	Credit Inc.	Debit Dec.	Credit Inc.	Debit Dec.	Credit Inc.	Debit Inc.	Credit Dec.
(1) 20,000					20,000				
(2) 8,000							8,000		
(3)			6,000					6,000	
(T) 28,000	=		6,000 +		20,000 +		8,000 -	6,000	

1-0320.00 DEBITS AND CREDITS (Cont'd)

4. The district borrowed $9,000 from the bank to cover future operating expenditures. This transaction increases assets and increases liabilities.

Assets		= Liabilities		+ Fund Balance		+ Revenues		- Expenditures	
Debit Inc.	Credit Dec.	Debit Dec.	Credit Inc.	Debit Dec.	Credit Inc.	Debit Dec.	Credit Inc.	Debit Inc.	Credit Dec.
(1) 20,000					20,000				
(2) 8,000							8,000		
(3)			6,000					6,000	
(4) 9,000			9,000						
(T) 37,000	=		15,000 +		20,000 +		8,000	6,000	

The accounting equation is still in balance, $37,000 = $15,000 + $22,000 ($20,000 + $8,000 - $6,000). Also note that each transaction involved credit amounts equal to the debit amount.

Now try analyzing some transactions yourself. Remember:

A debit - increases an asset
- decreases a liability
- decreases fund balance
- decreases revenue
- increases expenditure

A credit - decreases an asset
- increases a liability
- increases fund balance
- increases revenue
- decreases expenditure

Following is a list of nine transactions to be recorded on the cash basis of accounting. Take a separate sheet of paper, list the number from 1 to 9 and indicate which accounts (assets, liability, fund balance, revenue, expenditure) are to be debited and which are to be credited. When you have completed your list, check the answers against those shown below:

1. Tuition is collected.
2. Teacher salaries are paid.
3. Investment matures.
4. Money owed to the XYZ Company is paid.
5. Money is borrowed from the bank.
6. A telephone bill is paid.

1-0320.00 DEBITS AND CREDITS (Cont'd)

7. Investments are purchased.
8. State aid funds are received.
9. Custodians salaries are paid.

Your answers should be:

1. Debit Assets (Cash); credit Revenue.
2. Debit Expenditures; credit Assets (Cash).
3. Debit Assets (Cash); credit Assets (Investments).
4. Debit Expenditures; credit Assets (Cash).
5. Debit Assets (Cash); credit Liabilities (Loans Payable).
6. Debit Expenditures; credit Assets (Cash).
7. Debit Assets (Investments); credit Assets (Cash).
8. Debit Assets (Cash); credit Revenue.
9. Debit Expenditures; credit Assets (Cash).

1-0330.00 BOOKKEEPING RECORDS

In order for a district to utilize the accounting process, books and records must be maintained. These books and records may be classified into two major types; journals and ledgers.

Journals

A journal is a book of original entry. It is like a log book or a diary: that is, transactions are entered in it in the sequence in which they occur, in date order. As transactions occur, they are recorded first in the journal. This recording is called a journal entry and contains a summary of the transaction, the date on which the transaction took place, the accounts affected, how they are affected (whether debits or credits), the amounts to be debited or credited, and a brief description of the nature of the transaction.

A journal is classified as a general journal or a special journal. Special journals are used to record transactions of a like nature. Some examples of special journals include:

- revenue journal
- receipts journal
- expenditures journal
- disbursements journal
- payroll journal (payroll register)
- purchase order journal

All transactions could be recorded in a general journal. A sample general journal is illustrated below.

General Journal

Fund____ Page ________

Date	Account Title and Explanation	General Ledger Accountt Numbere	Posd	Debits	Credits

1-0330.00 BOOKKEEPING RECORDS (Cont'd)

Assume that on July 28, the district purchases $10,000 of U.S. Treasury bills as an investment for cash totaling $9,542. The actual entry in journal form is shown below. Note that the account to be debited is listed first and the account to be credited is listed second and indented - this is accepted practice. Also note that a brief explanation follows the recording of the account names.

General Journal

Fund____ Page________

Date	Account Title and Explanation	General Ledger Account Number	Posted	Debits	Credits
07/28	Investments	111	7	9,542.00	
	Cash in Bank	101	7		9,542.00
	(To record purchase of				
	U.S. Treasury bills in				
	the amount of $10,000)				

Ledgers

A ledger is a book that may be used to summarize the financial activity in each account of a district. It usually has a separate page for each account. Ledgers are classified as "general" or "subsidiary." The general ledger contains the basic accounts of the district, and serves as the source of data for preparing the balance sheet. A sample general ledger account is illustrated below.

General Ledger

Fund Account Title____

Account Number Page No. ________

Date	Description	Ref.	Debit	Credit	Balance

This general ledger format includes the "T" account, and has been modified to include a column to maintain a running balance of the account. The balance in the account will be a debit if entries in the debit column total more than those in the credit column; on the other hand, the balance will be a credit if credits total more than debits.

The accounts normally included in the general ledger are:

- individual asset accounts
- individual liability accounts
- individual equity accounts
- budgetary control accounts--Estimated Revenues (401), Appropriations (801), and Budgetary Fund Balance (952).
- revenue control account (402)
- expenditure control account (802)
- encumbrance control account (803)

Budgetary and encumbrance accounting will be discussed in subsequent chapters.

1-0330.00 BOOKKEEPING RECORDS (Cont'd)

An illustration of the posting to an individual asset account, "Cash in Bank," is shown below.

General Ledger

Fund General Account Title Cash______________________

Account Number 101 Page No. 1_______

Date	Description	Ref.	Debit	Credit	Balance
07/01	Balance Forward		81,090.40		81,090.40

Subsidiary ledgers provide detailed breakdowns of selected general ledger accounts. The most common subsidiary ledgers are:

- The Revenue Subsidiary Ledger
- The Expenditure Subsidiary Ledger

Posting

The process of taking the information from the journals and recording the same information in the ledgers is referred to as "posting."

1-0330.00 BOOKKEEPING RECORDS (Cont'd)

The previous journal entry is posted to the appropriate general ledger accounts as follows:

General Ledger

Fund General Account Title Cash

Account Number 101 Page No. 1

Date	Description	Ref.	Debit	Credit	Balance
07/01	Balance Forward		81,090.40		81,090.40
07/28	Check No. 3909	GJ-1		9,542.00	71,548.40

General Ledger

Fund General Account Title Investments

Account Number 111 Page No. 1

Date	Description	Ref.	Debit	Credit	Balance
07/28	$10,000 maturity value U.S. Treasury Bills	GJ-1	9,542.00		9,542.00

1-0330.00 BOOKKEEPING RECORDS (Cont'd)

The posting Reference column in the general ledger indicates which journal and page the posting came from. The balance column in the general ledger allows the bookkeeper to maintain a running balance in the account. Usually, each time the general ledger is posted, the accounts are totaled and the balance is entered with a notation as to whether the balance is a debit (DR) or a credit (CR).

General Journal

Fund____ Page_______

Date	Account Title and Explanation	General Ledger Account Number	Posted	Debits	Credits
07/28	Investments	111		9,542.00	
	Cash in Bank	101			9,542.00
	(To record purchase of				
	$10,000 U.S. Treasury bills				
	by warrant numbered 3909.)				

Numbers in the General Ledger Account Number column show to which accounts the journal entry was posted and the check marks in the posted column indicate the accounts have been posted.

1-0340.00 THE TRIAL BALANCE

If posting to the accounts has been done correctly, the total of all the debits posted should equal the total of all the credits posted. This is true because for every debit entry or entries there has been a credit entry or entries of an equal amount.

At the end of the month, when you are getting ready to prepare your reports, the first step is to prepare a trial balance for each fund. The General Fund trial balance would look like this:

SCHOOL DISTRICT XYZ
TRIAL BALANCE
GENERAL FUND
JULY 31, 20XX

General Ledger Account Number	Account Titles	Account Balances	
		Debit	Credit
101	Cash	66,000	
111	Investments	95,000	
180	Due from Other Governments	159,000	
220	Inventories for Consumption	3,500	
402	Revenue Control Account		5,000
670	Payroll Deductions and Withholdings		14,000
621	Accounts Payable		8,500
802	Expenditure Control Account	3,000	
970	Unreserved Fund Balance		299,000
		326,500	326,500

The debits and credits should be equal in the trial balance. A trial balance is necessary because errors can occur. For example, errors may occur while posting transactions to the ledger accounts. Numbers can be transposed (such as the accidental posting of a debit as $48 and the related credit as $84) or posting missed. The trail balance is simply a listing of all the account balances in the general ledger as a check to ensure the ledger is in balance.

1-0350.00 CHART OF ACCOUNTS

The chart of accounts is a listing of all accounts used in an individual accounting system. Each account is assigned a number, and is grouped in the ledger with similar accounts. Following is a simple chart of general ledger accounts showing current assets and current liabilities for the General Fund. Remember, assets are what the district owns, liabilities are what the district owes, and fund balance is the difference between the two. The number of accounts has been kept small to illustrate principles and procedures, but additional or different accounts may be necessary depending on the law and the needs of a particular district.

Current Assets

What the district owns:	Chart of Accounts General Ledger No.	Normal Balance
Cash	101	Debit
Petty Cash	103	Debit
Investments	111	Debit
Due from Other Governments	180	Debit
Accounts Receivable	190	Debit
Prepaid Expenses	240	Debit

Current Liabilities

What the district owes:

Accounts Payable	421	Credit
Accrued Salaries and Benefits	661	Credit
Payroll Deduction and Withholdings	670	Credit

Fund Equity

The difference between what the district owns and owes:

	Chart of Accounts General Ledger No.	Normal Balance
Reserve for Encumbrances	953	Credit
Unreserved Fund Balance	970	Credit

Control and Budgetary Accounts

Estimated Revenues	401	Debit
Revenues	402	Credit
Appropriations	801	Credit
Expenditures	802	Debit
Encumbrances	803	Debit

A complete list of accounts and their definitions may be found in Topic 3 of the School Accounting Manual.

1-0350.10 CONTROL ACCOUNTS

The Revenue Account (402), Expenditures Account (802), Estimated Revenues (401), Appropriations (801), Encumbrances (803) and the Reserve for Encumbrance account (953) are normally used as summary or control accounts. This simply means that the balances in these accounts are summaries of the balances of the detailed budget, revenue, expenditure or encumbrance accounts maintained in separate subsidiary ledgers. For example, revenue received from the federal government, the state, and from local sources is posted in total to the Revenues summary account (account 402). However, it is also necessary to keep a record of revenue from each individual source -federal, state and local. Therefore, a subsidiary revenue ledger is maintained which contains an account for each source of revenue in order to provide the detailed record needed. This ledger is called the Revenue Subsidiary Ledger or, simply, the revenue ledger. At all times, the total revenue shown in the general ledger Revenues account (402) should equal the total of the revenue amounts posted in the Revenue Subsidiary Ledger. When posting an item or items for which there is a control account, one would post the total to the control account and then post the individual amount(s) to the proper accounts in the subsidiary ledger.

The Revenue control account was used as a sample here; however, the same principle applies to any control account. Any subsidiary ledger should, like the revenue ledger above, be summarized in a single account in the general ledger. This is illustrated below using "T" accounts.

Assume that a district records the following revenues:

1. EHA Part B $20,000
2. State Equalization $30,000
3. Tuition $80,000

101 Cash in Bank	
Debit __	Credit__
(3) 80,000	

180 Due from Other Governments_____	
Debit__	Credit__
(1) 20,000	
(2) 30,000	

402 Revenue (Control)	
Debit__	Credit__
	(1) 20,000
	(2) 30,000
	(3) 80,000

And, the Revenue Subsidiary Ledger would look like this:

Out of District Tuition (Revenue Source 1310)	
Debit__	Credit__
	(3) 80,000

State Equalization (Revenue Source 3110)	
Debit__	Credit__
	(2) 30,000

EHA Part B (Revenue Source 4510)	
Debit__	Credit __(3)
	(1) 20,000

1-0360.00 GOVERNMENTAL AND COMMERCIAL ACCOUNTING

There are many similarities between governmental accounting and commercial, or private enterprise accounting. Both are concerned with controlling and reporting on financial position and results of operations. Both emphasize relevance, materiality, freedom from bias, comparability, consistency, and understandability. Both systems utilize:

- Double entry bookkeeping
- Many common terms (e.g., balance sheets, assets, liabilities, equity)
- Common accounting processes (e.g., journalizing, posting to ledgers, preparing of financial statements).

There also are significant differences between the two types of accounting. Some of these are:

- Objectives - While commercial enterprises are organized to make a profit for their owners, governmental entities exist to provide services to their citizens on a non-profit basis. Even though some district activities, such the food service program or the student store, provide commercial-like services, their primary objective usually is not to earn a profit.
- Reporting emphasis - Since governmental entities are primarily not seeking to increase capital, the accounting emphasis is not on profit. This emphasis requires the reporting of revenues and other financing sources (i.e., sale of bonds, interfund transfers) and expenditures and other uses of funds (i.e., interfund transfers, purchase of fixed assets, debt retirement) in the operating statements rather than on the balance sheet.
- Legal requirements and restrictions - Since governmental entities are created by law, they are continuously regulated by legal provisions. Their accounting records must illustrate that they have complied with all applicable laws and regulations. Most small commercial enterprises have more flexibility in their accounting processes than do governmental entities.
- Fund accounting - Because of these legal provisions and the diverse nature of governmental bodies, fund accounting is required. A fund is defined as a separate, self-balancing set of accounts which is separated for the purpose of carrying on specific activities or attaining certain objectives. Unlike a commercial enterprise, governmental entities must maintain separate funds, requiring a self-balancing set of accounts for each fund.

These and other characteristics of governmental accounting are formalized in a set of generally accepted accounting principles (GAAP) for governmental accounting. Throughout this chapter (and others), we will be explaining the principles which govern governmental accounting.

1-0360.10 ACCOUNTING FOR GOVERNMENTAL ORGANIZATIONS

The National Council on Governmental Accounting (NCGA) publishes the set of basic principles applicable to the accounting and reporting of all governmental organizations, including school districts. These principles prescribe the need for governmental units to maintain three categories of funds: governmental, proprietary and fiduciary. Fiduciary funds may be accounted for either as governmental or proprietary funds depending upon the nature of the particular fiduciary fund involved. A summary of these principles as applied to the operation of school districts is in Topic 5 of the School Accounting Manual.

1-0360.20 BASIS OF ACCOUNTING

One of the most important principles deals with the "basis of accounting." Basis of accounting refers to the point in time when revenues, expenditures or expenses (as appropriate), and the related assets and liabilities are recognized in the accounts and reported in the financial statements. In other words, the "basis of accounting" governs the **timing** with which the accounting system recognizes transactions.

There are three bases of accounting in common use: cash, accrual, and modified accrual. The accrual basis (or the modified accrual basis in the case of governmental fund types) is preferred by most professionals and standards setting groups because it presents a more accurate picture of the operations of the district. Montana school districts are required to use the modified accrual basis of accounting for governmental type funds and the accrual basis for proprietary type funds.

In cash basis accounting, financial transactions are recognized in accounting records only when money is paid out or taken in.

Under the accrual basis, revenues and expenses are recognized when the economic events which give rise to those revenues and expenses occur. Thus, revenues are recorded when they are earned (not necessarily when they are received in cash), and expenses are recorded when goods are consumed or services are rendered (not necessarily when cash is actually disbursed).

Since governmental fund type financial statements are concerned with spending and available spendable resources, rather than with a determination of net income, they are accounted for by using the modified accrual basis of accounting. The modified accrual basis is the accrual basis of accounting adapted to focus on spending rather than on net profits. Thus, revenues are recorded when they are "measurable" and "available," and expenditures are recorded when the liability is incurred (i.e. when goods or services are received).

The following paragraphs provide further elaboration of these concepts.

Cash Basis Accounting

With regard to cash basis accounting, the Municipal Finance Officers Association says:

"Cash basis accounting recognizes transactions only when cash changes hands. There exists no comprehensive set of cash basis accounting principles corresponding to the specifically defined sets of principles which comprise the accrual and modified accrual basis of accounting. As a result, the term cash basis accounting is used, in actual practice, to mean different things at different times."

In the simplest version of cash basis accounting, the balance sheet presents the cash balance of the entity as its only asset and does not recognize any liabilities. In such an instance, the balance sheet's representation of net worth (which is the difference between total assets and total liabilities) is simply the same amount as its cash balance. The statement of operations then presents as revenue only amounts actually received in cash and presents as expenditures only amounts which have actually been paid.

1-0360.20 BASIS OF ACCOUNTING (Cont'd)

This simple version of cash basis accounting is, however, seldom found in actual practice because it has potential to be misleading in certain situations. For example, cash received as proceeds from a loan taken out at the bank would be reflected as revenue on the operating statement, but no liability would be reflected on the balance sheet to indicate that the loan must later be repaid to the bank.

In such a system, the balance sheet presents as assets the entity's cash balance and any other assets arising from cash transactions (amounts receivable for loans previously made to other entities, material expenditure refunds, receivable, etc.). It presents as liabilities only those liabilities arising from cash transactions (amounts due as repayment for monies previously borrowed, employee payroll withholdings unremitted, etc.). In such an instance, the balance sheet's representation of net worth is the difference between the sum of its assets and the sum of its liabilities arising from cash transactions.

Cash basis financial statements are ordinarily not intended to present financial position or results of operations. They are intended to assist management with its internal planning of cash flows so that sufficient cash will be available to pay bills as they come due and so that excess cash might be invested until needed.

Cash basis financial statements omit recognition of assets and liabilities not arising from prior cash transactions. Accordingly, they ignore the effect upon financial position and results of operations of accounts receivable, accounts payable and other accrued items. Since these items are commonly of significant dollar magnitude, cash basis financial statements rarely present financial position or results of operation in conformity with generally accepted accounting principles.

For these reasons, authorities prescribe the use of the accrual basis of accounting or the modified accrual basis in the case of governmental type funds.

Accrual Basis Accounting

Under this method, revenues are recognized in the accounting period in which they are earned and become objectively measurable. When a revenue is earned, the district has provided the service. For example, a district food service program provides meals for the district National Honor Society sponsored by a local bank. After the meal, the revenue would be considered earned regardless of when the bank pays the bill.

Using the accrual basis of accounting, expenses, if measurable, should be recognized in the period incurred. Note the term "expenses" rather than the expenditures. The major difference in the terms is that expenses include various allocations of costs such as depreciation, but do not include the purchase of fixed assets or the payment of debt principle. The opposite is true for expenditures. This is to say, expenditures include purchase of fixed assets and the payment of debt principle, but do not include the allocation of cost such as depreciation. Expenses rather than expenditures, are recorded in proprietary funds.

1-0360.20 BASIS OF ACCOUNTING (Cont'd)

Modified Accrual Basis Accounting

Under the modified accrual basis, revenues should be recognized in the accounting period in which they become available and objectively measurable as net current assets.

Normally, a revenue becomes available when it qualifies as an asset. There are at least two exceptions to this statement in which the asset is recognized but the revenue is deferred.

1. Taxes Receivable - Taxes levied but not collected at fiscal year end are recorded as Deferred Revenue (680).

2. Externally imposed restrictions - An external restriction may be imposed on the district, precluding recording the increase in assets as revenue. For example, if a district receives funds in advance from a state or federal agency to finance the operations of a project in a subsequent year, the revenue should be deferred.

Revenues are considered measurable if the amount can be reasonably determined. Some revenues considered measurable are:

- State and federal grant reimbursement claims
- Tuition rates extended by the number of tuition students served
- Interest income projections

Some revenues which generally are not considered susceptible to accrual include income taxes, since the amount to be collected cannot be adequately determined.

Property taxes generally should be accrued when collected.

In applying the available and measurable criteria to federal, state and other grants, the terms of each grant must be reviewed. If expenditure of monies is the prime factor in determining grant eligibility, the revenue should be recognized at the time of recording the expenditure.

Expenditure should be recognized, under the modified accrual basis, when the liability is incurred. For the liability to be incurred, the service must be performed or the goods received. Normally, the expenditure is accrued when goods or services are received or repairs completed.

Some exceptions or alternatives to the above criteria include:

- Principle and interest on general long-term debt are recorded as expenditures only in the fiscal year when due, or may be recorded as expenditures at fiscal year-end if due early in the next year and resources are available to make the payment.
- Inventory items such as supplies may be recorded as expenditure either when purchased "Purchases Method" or when used "Consumption Method."

1-0360.20 BASIS OF ACCOUNTING (Cont'd)

- If the unused inventory not expended is significant, it should be reported on the balance sheet as an asset and a Fund Balance Reserve for Inventories.
- Expenditures which are prepaid for insurance and rent extending over more than one accounting period must be allocated between accounting periods.

As previously indicated, all accounting activity illustrated in this handbook is based on either the accrual or modified accrual basis of accounting, as appropriate.

1-0370.00 SUMMARY

1. A balance sheet shows the financial position at a given date.
2. An operating statement shows the changes in financial position and results of operations during a period ending on the balance sheet date.
3. The things a district owns are called assets.
4. The amounts a district owes are called liabilities.
5. The excess of assets over liabilities is called equity or fund balance.
6. Receipts are increases in cash.
7. Disbursements are decreases in cash.
8. Increases in assets or decreases in liabilities which result in an increase in fund balance are called revenue.
9. Decreases in assets or increases in liabilities which result in a decrease in fund balance are called expenditures.
10. Increases and decreases in equity are called revenues and expenses, respectively.
11. Fund accounting is used by districts to permit accounting separately for resources affected by different types of spending restrictions and/or accounting principles.
12. Debits are entries to the left side of the account.
13. Credits are entries to the right side of the account.
14. Assets normally have debit balances; therefore -
    debits increase assets
    credits decrease assets

1-0370.00 SUMMARY (Cont'd)

15. Liabilities and fund balances normally have credit balances; therefore -
    debits decrease liabilities and fund balances
    credits increase liabilities and fund balances

16. The original entry of a financial transaction in the records is made in a journal.

17. From the journal, transactions are posted to accounts in the ledgers.

18. A set of account records is called a ledger.

19. A trial balance is a listing of account titles, account numbers, and balances for the purpose of determining whether the accounts are in balance - whether the total of all debit account balances equals the total of all credit account balances.

20. Generally accepted accounting principles (GAAP) are standards for accounting and reporting. GAAP applicable to governmental organizations are published by the National Council on Governmental Accounting (NCGA).

21. The basis of accounting refers to the point in time at which transactions are recognized in the accounting system.

22. In cash basis accounting, financial transactions are recognized only when cash is taken in or paid out.

23. In accrual basis accounting, revenues are recognized when they are earned and expenditures are recognized when goods are consumed or services rendered. The accrual basis is used for proprietary type funds.

24. The modified accrual basis of accounting is used for governmental type funds. On this basis, revenues are recognized when they are available and measurable and expenses are recognized when a liability is incurred.

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